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The Deductibility of Antitrust Treble Damage Payments

Stephen B. Scallen

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I. INTRODUCTION

Any person injured by a violation of the antitrust laws may bring a suit for treble damages under section 4 of the Clayton Act.[1] The United States may bring damage claims for similar violations under section 4A of the Clayton Act[2] or under the Federal False Claims Act.[3] There is some doubt, however, as to whether damages paid as the result of such suits should be deductible as a business expense for federal income tax purposes.

The Internal Revenue Code provides: "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ."[4] The code itself sets out only two policy exceptions to the availability of this business deduction: bribes to foreign officials under section 162(c) and certain lobbying expenses under section 162(e). However, a judicial "public policy exception," denying the deduction for fines and penalties, has long been applied.[5] Thus, it may be argued that a deduction for the payment of damages arising out of violations of the antitrust laws should be disallowed, since such damages are arguably fines or penalties. In Revenue Ruling 64-224,[6] however, the Internal Revenue Service

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1. Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

15 U.S.C. § 15 (1964).

2. 15 U.S.C. § 15(a) (1964).

3. 31 U.S.C. § 231 (1964).

4. INT. REV. CODE of 1954, § 162(a).

5. Commissioner v. Longhorn Portland Cement Co., 148 F.2d 276 (5th Cir.), *cert. denied*, 320 U.S. 728 (1945); Burroughs Material Co. v. Commissioner, 147 F.2d 178 (2d Cir. 1943); Helvering v. Superior Wines & Liquors, Inc., 134 F.2d 373 (8th Cir. 1943); Tunnel Ry. v. Commissioner, 61 F.2d 166 (8th Cir. 1932), *cert. denied*, 228 U.S. 604 (1933); Chicago, R.I. & P. Ry. v. Commissioner, 47 F.2d 990 (7th Cir.), *cert. denied*, 284 U.S. 618 (1931); Great N. Ry. v. Commissioner, 40 F.2d 372 (8th Cir.), *cert. denied*, 282 U.S. 855 (1930).

6. 1964-2 CUM. BULL. 52. A partial bibliography of materials on the general subject includes: Arent, *Inequities in Non-Deductibility*

ruled that treble damages paid under section 4 of the Clayton Act are deductible as ordinary and necessary business expenses, but that damages paid to the United States under section 4A of the Clayton Act or under the Federal False Claims Act are not deductible.[7]

The purpose of this Article is to demonstrate that Revenue Ruling 64-224 is not supported by the relevant case authority, that it is not supported by the relevant policy considerations, and that its issuance was not an appropriate use of the ruling power.

II. THE AUTHORITIES

A. THE STATUTES AND LEGISLATIVE HISTORY

Neither the Internal Revenue Code nor the antitrust laws gives any guidance on the issue of the deductibility of antitrust treble damage payments.

1. *The Tax Law*

Congress has specifically provided for the denial of a deduction for certain illegal payments, such as payments made in violation of price regulations[8] and the payment of wages above specified ceilings,[9] but no such limitation has been included in the business expense deduction provision.

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of Fines, Penalties, Defense Expenses, 87 J. ACCOUNTING 482 (1949); Boland, *Income Tax Treatment of Antitrust Damages*, 22 TAX L. REV. 47 (1966); Diamond, *The Relevance of Public Policy in Disallowance of Income Tax Deductions*, 44 TAXES 803 (1966); Hart, *A Tax Formula To Restore the Historical Effects of the Antitrust Treble Damage Provisions*, 65 MICH. L. REV. 245 (1966); Noall & Traxell, *Tax Aspects of Antitrust Proceedings*, 18 TAX L. REV. 213 (1963); Paul, *The Use of Public Policy by the Commissioner in Disallowing Deductions*, U. So. CAL. 1954 TAX INST. 715; Comment, *Treble Damages—Tax Treatment and Antitrust Policy*, 27 CATH. U.L. REV. 102 (1967); Note, *Deduction of Business Expenses: Illegality and Public Policy*, 54 HARV. L. REV. 852 (1941); Note, *Present and Proposed Tax Treatment of Antitrust Treble Damage Payments*, 52 IOWA L. REV. 974 (1967); Note, *Taxation—Business Expenses Deduction of Clayton Act Treble Damages*, 45 N.C.L. REV. 1108 (1967); Comment, *Federal Taxation—Ordinary and Necessary Business Expenses and the Antitrust Laws*, 9 ST. LOUIS U.L.J. 417 (1963); Note, *Business Expenses, Disallowance and Public Policy: Some Problems of Sanctioning with the Internal Revenue Code*, 72 YALE L.J. 108 (1962); Comment, 35 FORDHAM L. REV. 677 (1967).

7. The Service also held that the expenses of defending the latter class of suits, including attorney fees, could not be deducted. That part of the ruling has been withdrawn and reversed by Rev. Rul. 330, 1966-2 CUM. BULL. 44, in the wake of Commissioner v. Tellier, 383 U.S. 687 (1966).

8. Revenue Production Act of 1950, § 405(a), *as amended*, 50 U.S.C. § 965(a) (1964).

9. Stabilization Act of 1942, § 5(a), 56 Stat. 767.

Prior to the passage of the Revenue Act of 1913,[10] however, a proposal to limit the deduction of illegal losses, particularly those resulting from gambling, was considered. Senator Sterling of South Dakota thought that the deduction for losses should be restricted solely to those "losses incurred in legitimate and ordinary trade pursued by the party."[11] However, Senator Sterling's proposal was defeated,[12] Senator Williams, the floor manager of the bill, clearly stating that the object of the legislation was "not to reform men's morals."[13]

In 1951, a similar proposal to deny the deductibility of "any expense paid or incurred in or as a result of illegal wagering"[14] was defeated.[15] While debate on this proposal, as on the previous one, was limited to the context of gambling expenses, Congress' failure to adopt the limitation does indicate that it had no intention of denying the deduction to all the general expenses of an illegal business.[16] Congress has not considered any further proposals to limit the business expense deduction on public policy grounds, although it has on rare occasions reacted to judicial decisions denying the deduction on such grounds.[17]

2. The Antitrust Laws

There is no indication in the antitrust laws themselves or in their legislative history that Congress considered the tax consequences of the payment of treble damages. The judicial decisions denying the deduction for fines and penalties do, however, provide a basis for the argument that the deductibility of antitrust treble damages should depend upon whether the payments are penal or remedial in nature. The claim that the treble damages payments are penal and, therefore, nondeductible, finds support in the legislative history of the Sherman Act.

In successfully urging rejection of an amendment to the Act which would have given state courts concurrent jurisdiction over the federal cause of action for treble damages, Senator Hoar, described as "in large measure the author of the [bill] in its

10. Revenue Act of 1913, §§ II(a) & G(b), 38 Stat. 166.
11. 50 CONG. REC. 3849 (1913).
12. *Id.*
13. *Id.* at 3850.
14. 97 CONG. REC. 12,230-31 (1951).
15. *Id.* at 12,244.
16. *Id.*
17. *E.g.*, INT. REV. CODE of 1954, § 162(e), added in reaction to Cammarano v. United States, 358 U.S. 498 (1959), discussed at text accompanying note 35 *infra*.

final form,"[18] characterized the treble damage provision as penal:

> This section . . . is a section establishing a penalty, threefold damages. . . . [N]o court enforces penalties except those created by the authority which creates the court, and no statute of any foreign or other authority but that can clothe the court with that power. . . .
>
> We might perhaps say that a person who owed to another a sum of money under an obligation solely the creature of a statute of the United States might recover in any State court; and if the obligation were created he could recover it equally, whether we said so or not; but we can not say that a State court shall be clothed with jurisdiction to enforce a claim for threefold the damages suffered, which is purely penal and punitive.[19]

The author of the concurrent jurisdiction amendment, Senator Reagan, replied:

> This measure is giving a civil remedy. It is not in the nature of prosecution for crime. It is a civil remedy for damage done. It is true that it fixes a part of the measure of the damages in a civil suit providing that the defendant may be required to pay triple damages and costs, and attorney's fees; but that is part of the measure of damages in a civil suit and is not in the nature of a prosecution for a crime.[20]

The debate centered on the characterization of treble damages as a penalty for the purpose of determining jurisdiction, not for the purpose of determining the tax consequences of their payment. Moreover, while Senator Reagan stressed the civil nature of treble damages in this and another context,[21] he did not deny that they would have a punitive effect on the guilty party. The thrust of Senator Reagan's argument was that treble damages were generally a civil remedy for the benefit of the injured party and that a state court *could* entertain a suit under that provision of the Act if Congress did not make the federal court jurisdiction exclusive.

It is clear, however, that these labels were applied for non-tax purposes and, therefore, should not mechanically control the tax consequences of the payment of treble damages. The treble damage provision is not exclusively either a punitive or a civil remedy; rather, it is at once a remedy for the injured party, an incentive for the injured party to enforce the antitrust laws, and a penalty against the violator. There is nothing inconsistent in this characterization, since, as pointed out by Justice

18. Haskell v. Perkins, 28 F.2d 222, 223 (D.N.J. 1928), *rev'd on other grounds*, 31 F.2d 53 (3d Cir.), *cert. denied*, 279 U.S. 872 (1929).
19. 21 CONG. REC. 3146-47 (1890).
20. *Id.* at 3147.
21. *Id.* at 2563.

Cardozo, "the same provision may be penal as to the offender and remedial to the sufferer. . . . The nature of the problem will determine whether we are to take one viewpoint or the other."[22]

B. THE SUPREME COURT NONTAX CASES

In Revenue Ruling 64-224, the Internal Revenue Service stated:

> Actions brought under Section 4 of the Clayton Act are remedial in nature since the purpose behind this section of the statute is to provide the victim with a means of recovering damages inflicted, and not to punish the wrongdoer, in the sense of a punishment "imposed and enforced by the State, for a crime or offense against its laws."[23]

In support of this statement, the Service cited four Supreme Court cases. Upon close examination, however, none of these cases provides support for the Service's position.

The language quoted in this passage is from *Huntington v. Attrill*,[24] which involved a New York judgment under a New York statute making the officers of a corporation liable for the corporate debts if they sign and record a false certificate of the amount of its capital stock. The Maryland Court of Appeals refused to give full faith and credit to this New York judgment on the ground that it had been entered in an action for a penalty. The Supreme Court, reversing the Maryland court, held that the statute was not penal in the conflict of laws sense:

> But as it gives a civil remedy, at the private suit of the creditor only, and measured by the amount of his debt, it is as to him clearly remedial. To maintain such a suit is not to administer a punishment imposed upon an offender against the State, but simply to enforce a private right secured under its laws to an individual. We can see no just ground, on principle, for holding such a statute to be a penal law, in the sense that it cannot be enforced in a foreign state or country.[25]

Thus, the Court held that an action is penal in the conflict of laws sense only if it is brought by the state to punish an offense committed against the state. However, the Court recognized that a statute may be penal for one purpose but not for another, stating that the New York statute involved could "be considered penal, in the sense that it should be strictly construed."[26]

22. Cox v. Lyke Bros., 237 N.Y. 376, 380, 143 N.E. 226, 227-28 (1924).
23. Rev. Rul. 224, 1964-2 CUM. BULL. 52, 54.
24. 146 U.S. 657, 667 (1892).
25. *Id.* at 676-77.
26. *Id.* at 676.

In *Huntington*, the Court gave the penal concept a restrictive meaning in the context of the full faith and credit clause, in order to facilitate the enforcement of the judgments of one state in the courts of another. Such a characterization for full faith and credit purposes does not provide a standard for the characterization of a statute in the tax context.

In the second case cited in the Revenue ruling, *Chattanooga Foundry & Pipe Works v. Atlanta*,[27] the Court, citing *Huntington*, held that a penal statute of limitations was not applicable to a treble damage claim under the Sherman Act. The Court's holding was consistent with the Sherman Act policy of discouraging anticompetitive business practices, but it does not provide much help in characterizing treble damages for federal income tax deduction purposes. It may suggest, however, that the antitrust laws should be given an interpretation for tax purposes that reinforces federal antitrust policy.

The third case cited, *Overnight Motor Transportation Company v. Missel*,[28] involved the question of whether the double damages authorized by the Fair Labor Standards Act[29] in the event of nonpayment of wages were mandatory and, if so, whether they were constitutional. Holding that they were both mandatory and constitutional, the Court stated that

> [t]he liquidated damages for failure to pay the minimum wages . . . are compensation, not a penalty or punishment by the Government. Cf. *Huntington v. Attrill* . . . . Nor can it be said that the exaction is violative of due process. It is not a threat of criminal proceedings or prohibitive fines, such as have been held beyond legislative power . . . . Even double damages treated as penalties have been upheld as within constitutional power.[30]

It is not clear why the Court stated that these payments were not penal, since it suggested that the double recovery would be constitutional even if characterized as a penalty. At any rate, although the Court concluded that the double damages provision was remedial in the context of the Fair Labor Standards Act, that characterization should not be controlling for purposes of the business expense deduction in the context of the antitrust laws.

The fourth case, introduced in the ruling by a "see also" signal, is *United States v. Cooper Corporation*,[31] in which the

27. 203 U.S. 390 (1906).
28. 316 U.S. 572 (1942).
29. 29 U.S.C. § 216(b) (1964).
30. 316 U.S. at 583-84.
31. 312 U.S. 600 (1941).

Supreme Court described the treble damage provision as "giving a civil action for an injury to property rights."[32] In *Cooper*, the Court excluded the United States from the statutory phrase "any person" entitled to recover treble damages under section 7, relying not on any characterization of the section as remedial or penal, but on fifty years of government practice, statutory construction, and the legislative history of the Act. The case contributes nothing to an analysis of the deduction issue, and the reference to "civil action" has no obvious meaning that can be transferred to the tax context.

The Service's use of language from nontax cases, which provides superficial support to a characterization of the treble damage provision as remedial without examining the policies involved in each case, is not the type of analysis modern legal scholars can accept. The *Cooper* case does not bear on the problem in any meaningful way, and the other cases cited do not support the conclusion that the provision should be characterized as remedial *only*. The only guideline which can be inferred from the cases is that the Court is likely to adopt a characterization which will implement the federal policy behind the antitrust laws.

C. The Supreme Court Tax Cases

1. *The Lobbying Expense Cases*

In *Textile Mills Security Corporation v. Commissioner*,[33] the Supreme Court denied deductibility to a contingent fee lobbying contract, basing its holding on public policy. In *Cammarano v. United States*,[34] the Supreme Court denied deductibility to expenses incurred to influence legislation.[35] In both cases, the Court relied heavily upon treasury regulations dating back to 1918 which prohibited deductions for such expenses. These cases, therefore, do not contribute to an analysis of the scope of the public policy exception as applied to potential deductions that are not the subject of longstanding regulations.

2. *The Illegal Expenses of an Illegal Business*

In *Commissioner v. Sullivan*,[36] the Supreme Court held that both the legal and illegal expenses of an illegal bookmaking

32. *Id.* at 608.
33. 314 U.S. 326 (1941).
34. 358 U.S. 498 (1959).
35. *See* note 17 *supra*.
36. 356 U.S. 27 (1958).

business are deductible. The payment of rent for premises used for bookmaking was itself illegal under Illinois law, but the Court, in a brief opinion, emphasized that the effect of denying the deduction would be the imposition of a gross income tax on the business. The Court indicated that the decision to tax an illegal business on the basis of gross income should be made by the legislature, not the courts.[37]

The *Sullivan* holding is sound for several reasons. The legislative history indicates that Congress has rejected proposals to limit the business expense deduction to legitimate expenses.[38] Denial of the deduction would eliminate the concept of a net income tax on an illegal business, and thus might involve a greater use of the federal tax law as an instrument to enforce local statutes than is desirable in a federal system. In addition, such a denial might lead to complete nonreporting of income by illegal businesses. Since the deterrent effect of denying the deduction is probably insignificant for an illegal business because of the alternative of complete tax avoidance, and since any danger of frustration of public policy which may result from denying the deductibility of illegal business expenses is outweighed by these other factors, the deduction was properly permitted.

3. Fines and Penalties

Tank Truck Rentals, Inc. v. Commissioner[39] is the most significant authority relevant to the subject of this Article. In that case, the Supreme Court held that fines paid for violations of a Pennsylvania maximum truck weight law were not deductible as ordinary and necessary business expenses, despite the fact that economic necessity compelled the taxpayer to operate the trucks fully loaded,[40] and despite a finding that "[o]peration of partially loaded trucks . . . would have created safety hazards. . . ."[41]

37. *Id.* at 29.
38. See text accompanying notes 10-17 *supra.*
39. 356 U.S. 30 (1958).
40. It is uncontested that trucking operations were so hindered by this situation that neither petitioner nor other bulk liquid truckers could operate profitably and also observe the Pennsylvania law. . . . Operation of partially loaded trucks . . . would have been economically impossible for any carrier so long as the rest of the industry continued capacity loading. And the industry as a whole could not operate on a partial load basis without driving shippers to competing forms of transportation.

Id. at 32-33.
41. *Id.* at 32.

The Court also denied deductibility to fines imposed for innocent violations of the weight limit statute, such as those caused by temperature changes in transit.[42] The taxpayer had relied upon the holding of the Second Circuit in *Jerry Rossman Corporation v. Commissioner*,[43] allowing deductions for amounts inadvertently collected as overcharges by the Office of Price Administration, and then paid over to the Government. In *Rossman*, Judge Learned Hand first concluded that a simple repayment of the overcharge without the additional double damages provided by the Act was not a penalty.[44] However, even if such a repayment were to be characterized as a penalty, Hand pointed out that "there are 'penalties' and 'penalties', and . . . some are deductible and some are not."[45] Judge Hand then concluded that allowance of the deduction did not frustrate the public policy underlying the Act, since the Administrator claimed discretion not to sue for treble damages in cases of inadvertent violation.[46] However, since the Pennsylvania statute involved in *Tank Truck Rentals* did not differentiate between willful and innocent violators, the Court concluded that state policy would be equally frustrated by allowing the deduction of the specified overweight charges in either case.

The Supreme Court might have distinguished *Rossman* on the ground that it did not involve a penalty, or at least that it did not involve a criminal penalty. Instead, the Court seized upon the frustration doctrine as formulated by Hand, concluding that although a deduction is allowed for ordinary and necessary business expenses, "[a] finding of 'necessity' cannot be made . . . if allowance of the deduction would frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some governmental declaration thereof."[47]

42. *Id.* at 36-37.
43. 175 F.2d 711 (2d Cir. 1949).
44. The *Rossman* holding that there was no penalty since no damages were paid beyond the amount of the overcharge may give some support to the *denial* of the deduction of antitrust treble damages beyond the actual amount of injury, although the Service cited *Rossman* in *support* of its analysis in Revenue Ruling 64-224.
45. 175 F.2d at 713.
46. *Id.* at 714.
47. 356 U.S. at 33-34. In support of this statement, the Court cited Commissioner v. Heininger, 320 U.S. 467 (1943), which held that the legal expenses of defending a mail fraud case were deductible, and Lilly v. Commissioner, 343 U.S. 90 (1952), which held that expenditures by opticians as kickbacks to doctors were deductible. The Court then said that the frustration doctrine

was foreshadowed in *Textile Mills Securities Corp. v. Commis-*

The Court examined the state policies behind the maximum truck weight statute, the deterrence issue, and the possible frustration of public policy if the deduction were allowed, and concluded that the fines were penalties and not just a revenue raising toll.[48] The facts were rather weak in this respect, however, as the Court admitted:

> It is true that the Pennsylvania statute provides for purchase of a single-trip permit by an overweighted trucker; that its provision for forcing removal of the excess weight at the discretion of the police authorities apparently was never enforced; and that the fines were devoted by statute to road repair within the municipality or township where the trucker was apprehended.[49]

Although the state policy was clearly defined, the fines were small and were assessed only in Pennsylvania and only on the drivers. If the state had been seriously interested in enforcing its public policy, it might have employed more serious sanctions, such as unloading, increased fines for repeating offenders, jail sentences, and license revocations.[50] Thus, the Court's conclusion that the fines were not a revenue raising toll was based solely on the fact that the fine was assessed and paid only when a violation of the weight limit statute was detected and the violator was apprehended by the police.[51]

Nevertheless, the Court's analysis of the deductibility problem is useful:

> Petitioner's failure to comply with the state laws obviously was based on a balancing of the cost of compliance against the chance of detection. Such a course cannot be sanctioned, for judicial deference to state action requires, whenever possible, that a State not be thwarted in its policy. We will not presume that the Congress, in allowing deductions for income tax purposes, intended to encourage a business enterprise to violate the declared policy of a State. To allow the deductions sought

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sioner, 314 U.S. 326 (1941), where the Court, finding no congressional intent to the contrary, upheld the validity of an income tax regulation reflecting an administrative distinction "between legitimate expenses and those arising from that family of contracts to which the law has given no sanction." 314 U.S., at 339. Significant reference was made in *Heininger* to the very situation now before us; the Court stated, "Where a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction for its payment." 320 U.S., at 473.

356 U.S. at 34.

48. 356 U.S. at 34.

49. *Id.* at 36.

50. Indeed, the state subsequently enacted a statute requiring unloading and progressive fines. At the same time, however, the weight restriction was raised to 60,000 pounds, the same restriction adopted by the adjoining states.

51. 356 U.S. at 34, 36.

> here would but encourage continued violations of state law by increasing the odds in favor of noncompliance. This could only tend to destroy the effectiveness of the State's maximum weight laws.[52]

The Court added that:

> the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction. The flexibility of such a standard is necessary if we are to accommodate both the congressional intent to tax only net income, and the presumption against congressional intent to encourage violation of declared public policy.
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> . . . Deduction of fines and penalties uniformly has been held to frustrate state policy in severe and direct fashion by reducing the "sting" of the penalty prescribed by the state legislature.[53]

While the Supreme Court used both deterrence and frustration language, the deterrence argument was of very doubtful applicability given the economic necessity for violating the statute. Also there seems to have been only a marginal amount of frustration, since the state policy was so weakly stated and enforced. This is in sharp contrast to the antitrust laws in which deterrence is much more of a factor, the policy concerned is a federal one and therefore entitled to more respect, and serious sanctions are provided. The most serious of the sanctions, arguably, is the treble damage provision. Consequently, the use of the *Tank Truck Rentals* rationale to deny the deduction appears more appropriate in the context of a treble damage case than in *Tank Truck Rentals* itself.

4. *Deductibility of Attorney Fees*

In *Commissioner v. Heininger*,[54] the Supreme Court upheld deductions for attorney fees and other expenses incurred in an unsuccessful battle against an administrative fraud order issued by the Postmaster General. In *Commissioner v. Tellier*,[55] the Court also upheld deduction of the costs of unsuccessfully defending a criminal prosecution under the federal securities acts. The Court rejected the suggestion that the public policy exception to section 162(a) warranted denial of the deduction,[56] stating that the exception should be narrowly applied:

> Only where the allowance of a deduction would "frustrate sharply defined national or state policies proscribing particular

52. *Id.* at 34-35.
53. *Id.* at 35-36.
54. 320 U.S. 467 (1943).
55. 383 U.S. 687 (1966).
56. *Id.* at 690.

types of conduct" have we upheld its disallowance. *Commissioner v. Heininger*, 320 U.S., at 473. Further, the "policies frustrated must be national or state policies evidenced by some *governmental* declaration of them." *Lilly v. Commissioner*, 343 U.S., at 97. (Emphasis added.) Finally, the "test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction." *Tank Truck Rentals v. Commissioner*, 356 U.S. 30, 35.[57]

The Court thus balanced the bias for taxing only net income against the deterrence and frustration factors. In *Tellier*, it concluded that no public policy was offended by the exercise of constitutional right to counsel and found no reason to add nondeductibility of the attorney fees to the other sanctions of the securities acts. The very remote deterrence and frustration relationship between the penalty for wrongdoing and the costs of defending and the recent emphasis upon the importance of the right to representation both contributed to the Court's conclusion that a deduction should be allowed. Thus, the *Tellier* case represents no real retreat from the preceding line of cases.

In *Tellier*, the Court said that the availability of the business expense deduction could be denied by specific legislation.[58] In the long footnote following, the Court cited several examples of specific legislation denying deductions for payments that violate public policy.[59] Finally, in a citation beginning with a "cf." signal, the Court referred to a congressional joint committee proposal to deny the deduction to treble damage payments.[60] Some commentators apparently construe this reference to the issue under consideration as a mini-opinion indicating Supreme Court approval of the position taken by the Service in Revenue Ruling 64-224.[61] It is difficult to accept this construction. The Court merely referred to the committee proposal for specific legislation as an example to show that Congress has considered measures to specifically disallow deduction of certain classes of expenditures. Moreover, the Court stated that it recognizes certain limited exceptions to the general policy of allowing business expense deductions "where Congress has been wholly si-

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57. *Id.* at 694.
58. *Id.* at 693.
59. *Id.* at 693 n.10.
60. *Id.*

. . . . Joint Committee on Internal Revenue Taxation, Staff Study of Income Tax Treatment of Treble Damage Payments under the Antitrust Laws, Nov. 1, 1965, p. 16 (proposal that § 162 be amended to deny deductions for certain fines, penalties, treble damage payments, bribes, and kickbacks).

61. *See, e.g.*, Bolland, *Income Tax Treatment of Antitrust Damages*, 22 TAX L. REV. 47, 57 (1966).

lent."[62] The Supreme Court knows how to indicate its position on a matter not directly under consideration. The bare citation of a committee proposal dealing with the treble damage problem can hardly be interpreted as an indication of how the Court would decide the question if it were presented.

5. *Application of the Cases*

The cases cited by the Internal Revenue Service in Revenue Ruling 64-224 are not particularly apposite. The principles used by the Supreme Court in the cases it has considered indicate that the deduction for the penal portion of treble damages should be denied. The frustration and deterrence factors are much more strongly present than in the *Tank Truck Rentals* case. The policy is a federal policy, not just a state policy, and the degree of seriousness of the offense, indicated by the severity of the penalties and the diligence of enforcement, is far greater than in *Tank Truck Rentals.*

There are other lower federal court cases which might be discussed, but most contribute little to an naalysis of the problem, and none raises the issue directly.[63] The cases which do analyze the treble damage payments and characterize them as penal or remedial do not contribute to analysis of the tax deduction problem, since the purpose for the characterization in each case is completely different. In any case, the relevant policies behind the statute must be considered and weighed. The sort of legal analysis used by the Service in the revenue ruling was simply mechanical jurisprudence which did not meet the important issues and did not discuss the relevant cases in any meaningful way.

The fact that the treble damage penalty arises out of a civil case and is not paid to the federal government can hardly have much bearing, in view of the kind of analysis employed by the Supreme Court. Deterrence and frustration are just as much present, whether or not the state or federal treasury is enriched by the payment. The intended role of treble damages as an enforcement measure is clear.

The conclusion in the ruling that damages paid to the United States under section 4A of the Clayton Act or under the Fed-

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62. 383 U.S. at 693.
63. The cases are discussed in STAFF STUDY OF INCOME TAX TREATMENT OF TREBLE DAMAGE PAYMENTS UNDER THE ANTI-TRUST LAWS, JOINT COMMITTEE ON INTERNAL REVENUE TAXATION 24, 30-31, 36-38, 46-59 (1965).

eral False Claims Act are in the nature of a penalty for injury to the public[64] is rather startling. Such damages, *not* trebled, would seem to be more like mere restitution or an adjustment of price. The *treble* damages bear a greater resemblance to punishment for violations. The accident that the payment is to the government does not provide a satisfactory basis for distinction. The law is violated to the same degree whether it is the government or a private party that is injured. It is difficult to see how simple damages would be punishment in any sense. Whether a deduction *should* be given for the restitutionary portion of a judgment is a close question on the policy level,[65] but the revenue ruling is seriously inconsistent when it denies a deduction for simple antitrust damages and allows a deduction for treble damages.

III. THE POLICY CONSIDERATIONS

While the Supreme Court decisions, read with some attention to the context of each case, suggest that antitrust treble damage should not be deductible as a business expense for federal income tax purposes, careful analysis of the competing policies involved in this matter must be undertaken before any definite conclusion can be reached. It is only proper to let policy considerations control, since the issue has not been decided by the Congress or the Court, and the existing authorities can usually be manipulated to "support" almost any result, as Revenue Ruling 64-224 so aptly demonstrates.

A. THE CASE FOR DENIAL OF THE DEDUCTION

1. Deterrence

The deterrence argument simply stated is that the denial of a deduction for antitrust treble damage payments increases the penalty for violation of the antitrust laws, thereby increasing the risks associated with violation and contributing materially to deterring violation of those laws. It is difficult to prove empirically that any deterrence results from a penalty imposed directly by law. The deterring effect of any penalty which is imposed indirectly through the operation of the federal income tax laws is just as difficult to prove. It appears, however, that the deterrence provided by denial of the deduction of a treble damage payment should be actual and substantial.

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64. Rev. Rul. 64-224, 1964-2 CUM. BULL. 52, 54.
65. See part III, C *infra*.

There is no doubt that denial of the deduction increases the penalty and the risk of violation. By way of illustration, assume that a violator has made a profit of $100,000 before taxes as the result of conduct that is a violation of the antitrust laws. Assume also that the profits and any deductions involved in payment of damages will all be related to a combined effective federal and state income tax rate of fifty per cent. The after-tax profit from the violation would be $50,000. Assume further that the violation is detected, the offender is convicted, and treble damages of $300,000 are assessed and eventually paid.[66] If a deduction is allowed for the $300,000 treble damage award or a settlement payment in that amount, the after-tax cost of the payment will be $150,000. Thus, the violator will have to get away with two out of three violations which generate the same amount of illegal profit in order to break even. If the deduction is denied, the after-tax cost of the treble damage payment will be $300,000, and the violator will have to get away with five out of six similar violations in order to break even. If a deduction is denied for the penal two-thirds of the payment the after-tax cost of the payment will be $250,000, and the violator will have to get away with four out of five similar violations in order to break even.

This additional indirect penalty resulting from denial of the deduction is therefore substantial and should be a deterrent to any businessman considering the costs of a possibly illegal course of action. The threat is one of very large losses if those injured by violations pursue the treble damage remedy with vigor, as may easily happen when there is first a criminal conviction which eases the burden of proof for those who seek civil relief for damages caused by the same activity.[67]

Since a judgment that the Act has been violated may subject the violator to treble damages, criminal sanctions, injunctive relief, and substantial adverse publicity, it might be argued that the denial of deduction of treble damage payments does not provide a necessary additional deterrent. However, whatever the deterring effect of these other sanctions might be, the only

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66. For the sake of simplicity, we will not explore in any precise way problems of discount, settlement discount, rate of discovery of violation, success in pressing claims, expenses of litigation, and other possible penalties and factors.

67. Clayton Act § 5(a), 15 U.S.C. § 16(a) (1964), provides that any final judgment or decree in an action brought by the U.S. against a defendant is prima facie evidence against the defendant in subsequent actions.

sanction that has any substantial financial impact is the treble damage award, and that financial impact is, in effect, doubled for a taxpayer in the fifty per cent bracket by denial of the deduction. For example, in the notorious electrical industry antitrust cases, the total fines as of 1965 were $2,000,000, while settlements of $300,000,000 in the civil suits were predicted.[68] Each criminal offense can lead to a maximum fine of only $50,000,[69] and criminal sanctions may seem very remote to the typical executive who probably knows few, if any, executives who have ever been fined and even fewer who have ever been imprisoned for antitrust violations. Thus, the treble damage penalty appears to be the most significant in terms that are likely to be relevant to business decision makers.

2. Frustration of Public Policy

A further reason for denying the deduction of any expenditure on the basis of public policy is that allowance of the deduction will in some way "frustrate" the public policy of the jurisdiction that enacted the regulatory law which has been violated. The frustration argument appears to cover some of the same ground as the deterrence argument, since it is used to describe at least two distinguishable effects: (1) frustration occurs because the deduction reduces the penalty and the sting of the penalty, and (2) frustration occurs because the deduction reduces the deterring effect of the penalty.

The two elements of frustration are illustrated in the *Tank Truck Rentals* case, where the Court seemingly used the frustration and deterrence language interchangeably. The facts of *Tank Truck Rentals* do not suggest any real deterrence factor in the penalties therein involved because the economic need to violate the weight limits was great and the cost, given the remote chance of being caught, was very small. The allowance of the deduction would have made the policy of deliberate violation even more profitable, but any *actual* deterrence was hard to find. Thus, if frustration of public policy means only the lessening of deterrence, then there was little or no frustration either. But the danger of frustration involved in *Tank Truck Rentals* arguably was not the lessening of deterrence, despite the Court's confusing use of language. The real frustration was in the reduction of the punitive effect or the "sting" of the penalty which would have resulted from allowance of the deduction and

68. STAFF STUDY, *supra* note 63, at 21, 44.
69. 15 U.S.C. § 1 (1964).

would have offended the public policy of the jurisdiction that enacted the regulatory statute. Presumably, a federal regulatory policy, such as that embodied in the antitrust laws and its major enforcement tool, should be entitled to even greater respect from the federal courts than a marginally expressed state policy, such as that involved in *Tank Truck Rentals.* Thus, the deduction should be disallowed to prevent any reduction in the punitive effect of treble damages.

Furthermore, the element of frustration of the policy of the antitrust laws is found not only in the reduction of the "sting," but also in the arbitrary and whimsical way in which the reduction occurs. The amount of relief from the penalty provided by a deduction varies because of differences in the tax status of the violators. One violator may have his top income taxed at combined federal and state rates exceeding seventy-five per cent, others at fifty per cent, some at twenty per cent, and a few have no taxes at all because of losses. The relief provided by the deductions, therefore, is a reduction of the penalty at the above rates. Ordinarily, all other things being equal, we prefer to see greater penalties imposed on those who are affluent than on those who are not, but the tax effect of a deduction for the treble damage penalty has the opposite effect. It is whimsical for the tax relief from a penalty to depend upon the tax bracket of the offender in a way that is unrelated or inapposite to the policies that ordinarily determine the amount of penalties.[70]

B. Arguments Against Denial of the Deduction

1. *A Tax on Net Income*

It is generally true that our income tax is imposed on net rather than gross income. Consequently, any public policy exception which denies deduction to an otherwise deductible business expense is inconsistent with this principle. On the other hand, there may be strong reasons to deviate from the general net income principle in cases where some specific and important objective is thereby served.

However, we must be cautious in the use of the Internal Revenue Code to encourage or discourage specific conduct. If we attempt to discourage too broad a scope of activities through

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70. It has been argued that the denial of the deduction is arbitrary because the resulting increase in the tax burden is dependent upon the tax bracket of the violator. However, granting the deduction is more arbitrary than denying the deduction because of the preference for having greater penalties fall on those who are more affluent.

the denial of deductions, the effect may ultimately be tax neutrality with respect to the activities which we sought to discourage.[71] Furthermore, extensive use of the denial of deductions may lead to widespread nonreporting of income when the burden of taxation without deductions becomes too great. Therefore, it would seem best to restrict such use of the Code in order to retain the effectiveness of the technique and to keep the taxing system generally consistent with the principle of taxing net income. Nevertheless, it seems clear that the limited use of the denial of deductions for criminal fines and certain other penalties such as antitrust treble damage payments will not compromise the net income principle in any significant way.

2. Neutrality

It has been argued that the tax system should maintain its neutrality toward the character of the income taxed and, therefore, that deductions should be allowed for fines and penalties.[72] However, it is not easy to determine what position is neutral. Even though a deduction may serve neutrality as a matter of tax law, it does not necessarily serve neutrality so far as antitrust policy is concerned. In addition, the whimsical results of deduction may be very offensive. It is not obvious, therefore, that allowing the deduction and thereby affording real relief from a sanction imposed by a nontax law is a neutral result.

This search for neutrality is question begging since what is really needed is a balancing of both the relevant tax and other statutory policies, not merely an invocation of conclusions from a partial analysis of the matter.

3. Regulation in Nontax Areas

It has been argued that the federal income tax system should not be used in any manner to enforce other laws or regulations.[73] The use of the tax system as a means of regulation is wrong, it is argued, because such indirect regulation was never intended by Congress and because it is better done directly.

71. *See, e.g.*, Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567 (1965); Sneed, *Fundamental Concepts of Public Law Symposium, No. 7, Taxation*, 11 J. PUB. L. 3, 13 (1962).

72. *E.g.*, Keesling, *Illegal Transactions and the Income Tax*, 5 U.C.L.A.L. REV. 26, 36-37 (1958).

73. *See, e.g.*, Paul, *The Use of Public Policy by the Commissioner in Disallowing Deductions*, U. SO. CAL. 1954 TAX. INST. 715.

This principle that the tax system was not intended for regulation and enforcement outside the tax area is generally accepted, but it is frequently violated by Congress itself. In regard to a particular deduction it is useful only as a cautionary principle, since it does not aid an objective analysis to start with the conclusion.

Moreover, it is not proper to talk of the specific intention of the Congress on a narrow point in a complex statutory pattern, since Congress probably never considered the matter either in passing the treble damage provision or in enacting the tax laws. Since we are unable to find any expression of congressional intent, we must either try to guess at what Congress would have done or, more realistically, decide on the merits what, as a matter of policy, should be done in an area which Congress has left open.

The general principle that direct regulation is more desirable than indirect regulation does not help to solve our problem either. The antitrust laws provide direct regulation of the proscribed conduct in this area. It must be determined whether indirect regulation through the tax laws would aid, hinder, or not affect the direct regulation at all. Given the beneficial effect to the violator of allowing the deduction, as well as the other policy factors, it seems that indirect regulation by a denial of the deduction is appropriate here.

4. *Antitrust Damages Are Not Criminal Fines*

It has been argued that because antitrust damages arise out of civil rather than criminal actions the deduction should be permitted.[74] This argument appears to be a rather technical one, based on a few lower court decisions,[75] not examined in this Article, which do not themselves compel any specific result. Moreover, these cases do not relate consistently to the Supreme Court's policy approach to the availability of the deductions, where such technical distinctions are irrelevant. Rather, it is important to decide what policies will be served by granting or denying a deduction. In this connection the policies rather than labels should control. If federal policy is clearly expressed by the treble damage provisions, and if no deduction would be desirable for reasons of deterrence and frustration, then the civil or criminal labels have no real significance. Even on the level of labels, a sanction such as treble damages may have a

74. *See* STAFF STUDY, *supra* note 63, at 36-38.
75. *See* note 63 *supra*.

greater penal effect than a criminal fine and, on the policy level, this is one of the important factors in the case for deterrence.

5. *Inadvertent Violators*

The plight of the inadvertent violator initially provokes a sympathetic response. If a company is convicted of violating the antitrust laws under some new theory retroactively applied, deterrence and frustration seemingly are not involved. It could be argued that in such cases, there should be an exception to the usual policy of denying the deduction, or it could be argued that, in view of the desirability of such an exception and the difficulty of distinguishing intentional from inadvertent violations it would be better to grant the deduction to all violators.

The Supreme Court held squarely the opposite in *Tank Truck Rentals.* But most of the cases *do* involve "hard core," intentional violations rather than violations which are on the horizon of an antitrust enforcement theory. It is beyond dispute that the cases which led to Revenue Ruling 64-224 were hard core cases. Moreover, it is illogical to allow the comparatively rare case of the inadvertent offender to control the result in the case of the intentional violator.

Since it is difficult to distinguish the intentional violator from the inadvertent, or the hard core case (for instance, price-fixing) from the fringe case (perhaps a merger that occurred fifty years ago), there should not be any difference in result among them. Creation of a system for the separate treatment of these cases is a task for which Congress is far better suited than the courts. Therefore, the deduction should be denied in all cases, unless or until Congress distinguishes among them.

Even if it were easy to identify the fringe and inadvertent violator, there is another reason for not treating him differently. The imposition of substantial sanctions, including the increased penalty of the denial of a tax deduction, on fringe and inadvertent violators will increase the businessman's incentive to be well informed on the antitrust laws and more careful in his business. He will have more reason to avoid not only hard core violations, but also other activities that may arguably be violations of the antitrust laws.

6. *Other Ways to Deter Offenders*

There are, of course, other ways to deter offenders. The penalty may be increased. The deduction could be selectively denied, on a case-by-case basis, either in the tax courts or in the other courts where the fine or penalty is imposed. Jail sentences could be imposed. Congress could decide which categories of cases should be denied deductions. Congress might decide to permit a company one antitrust violation with a deductible treble damage payment, to deny the deduction only in hard core cases, or to deny it only after a criminal conviction. But these proposals should be considered by Congress, since they call for rather particularized legislation which is not characteristic of the judicial process.[76]

7. Other Antitrust Considerations

It has been suggested that antitrust policy factors other than deterrence should be considered. One argument is that since denying the deduction in the electrical equipment cases would have upset competition in the electrical industry by destroying the small competitors,[77] it could have the same effect in other cases. This argument, however, is applicable only to small but profitable concerns, since the deduction would be of little or no value to a truly marginal operation. In the abstract, it is difficult to see how denial of the deduction would push under a small but profitable operation. In addition, it is a rather difficult argument for a court or the Internal Revenue Service either to evaluate in general or to apply in particular cases. Although it might be relevant in a particular case, it should not be a prime consideration in deciding whether to allow the deduction to all companies, including the largest. If relief from the effects of treble damage payments is needed by a few companies in order to preserve competition, the legislature would be a more appropriate place to file the request for such relief.

Another argument against denying the deduction is that the cost of any treble damage payment is ultimately passed on to consumers in the form of higher prices, so that increasing the burden by taxation would only increase the prices to consumers. Even though it probably is true that taxes and other typically recurring costs are passed on to consumers, it appears more doubtful that an unusual one-time cost such as a treble damage

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76. Bills have been introduced by Senator Hart, S. 2804, 90th Cong., 1st Sess. (1967) and by Senator Long, S. 2963, 90th Cong., 2d Sess. (1968), to specify in detail the tax treatment of antitrust treble damage payments.

77. STAFF STUDY, *supra* note 63, at 32, 38 (points made by interested parties in industry).

payment would be passed on. Since it is not clear that higher prices would follow, some substantial data or proof should be offered before this argument is accepted. However, even if data demonstrating passing on is produced, the deterrence and frustration factors more than offset its effect.

C. Balancing the Interests

The tax-net-income-only principle must still be reconciled with the policy reasons for denying the deduction. It would certainly not be advisable to deny the deduction for every sort of undesirable expense the mind of man can imagine. That would be too much of a departure from a net income tax, would be too much of an excursion of the tax law into the area of regulation, and would not be selective enough to provide real deterrence where it is needed. Moreover, compliance and collection difficulties might be increased. It would not be wise to try to impose, in effect, a gross income tax on illegal businesses. But a denial of the deduction for criminal fines is a far narrower, limited sanction which can be easily applied.

In the case of antitrust treble damage payments, the injurious activity might also be a criminal violation, but it is not necessarily so in every case. In addition, there is an important federal policy involved. Thus, it appears that the deterrence and frustration factors are fully applicable. Treble damage payments are unlike ordinary, compensatory damages for a tort or breach of contract. Instead treble damage payments are explicitly punitive and extraordinary and are intended to be, or at least have the effect of being, a penalty for engaging in undesirable activity. This penalty is an important adjunct to the criminal penalty in that it brings the injured party into the enforcement mechanics of the Act. This function of providing the injured party with an incentive to sue takes nothing away from the penalty function of treble damages. They are consistent with and reinforce each other.

The decision ultimately involves a choice between increasing the penalty or decreasing it. Clearly, it is better to increase the sanction in this limited area, since such an increase is consistent with important policies behind the antitrust laws. In addition, increasing the penalty by denying a deduction for its payment produces a coherent and rational system consistent with the existing Supreme Court cases. Treble damages are thought to be more of a penalty than overweight truck fines. Consistency and fairness in tax administration require that persons similarly situated receive similar treatment. If antitrust treble damages are fully deductible, those who are denied deductions for fines imposed for less serious infractions are not treated fairly.

Having balanced all the relevant considerations, and having decided to deny the deduction, the question of whether the denial of deduction should apply to the entire treble damage payment or just to the punitive two-thirds still remains unanswered. Part of a treble damage award frequently represents an adjustment of price between a buyer and seller. In other cases, the amount proved as actual damages bears a considerable resemblance to tort damages. In both cases, it may be desirable to allow a deduction for the actual damage proved. Allocation problems could be left to the taxpayer to resolve, with the Service's approval. In the absence of proof, one-third of each award or settlement paid could be presumed to be actual damages, and only the punitive part of the award would be denied deduction.

This refinement would preserve the tax-net-income-only principle for the part of the award that more closely resembles a price adjustment or a tort judgment. This has theoretical appeal since it breaks the payment down into its compensatory and punitive elements and treats each as other analogous payments of the same type are treated. The deterrence factor is maintained, although it might be argued that it is only two-thirds as effective. Frustration should not be affected since the punitive element of the damages would not be deductible, reinforcing the federal policy behind the antitrust treble damage provisions.

Determining whether the price adjustment part of the treble damage payment should be deductible is a difficult balancing problem. The deduction approach seems better on theoretical grounds, but a contrary decision to emphasize the deterrence aspect would certainly be justified.

If a deduction for the simple price adjustment part of the award or settlement is granted, a question arises concerning payments to the government. Revenue Ruling 64-224 holds that payments of simple damages to the United States are not deductible.[78] There is, however, no reason to treat payments to the Government and payments to a private plaintiff differently. The elements of deterrence and frustration are the same. If frustration is evident in a case brought by the Government, then it will likely be equally as evident in a case brought by a

78. Rev. Rul. 64-224, 1964-2 Cum. Bull. 52, 54.

private plaintiff. The frustration does not depend upon the identity of the plaintiff.

The identity of the plaintiff will, however, determine whether there can be *treble* damages, since the United States is not permitted to recover them.[79] In such cases, if the damages represent an adjustment of price, a deduction would be appropriate, if it has been decided to grant the deduction for the nonpunitive part of the award in the treble damage case.

IV. THE PROPRIETY OF ISSUING THE RULING

It has been argued above that both the relevant policy considerations and the relevant authorities suggest denial of the deduction. It may, however, also be argued that the issuance of Revenue Ruling 64-224 was highly improper and involved a gross misuse of the ruling power. The revenue consequences of this ruling are as great as any that have ever turned on a revenue ruling. Political pressure to issue it in a form granting the deduction was very intense, and there may have been some feeling in high places that the government should do something to indicate that it was not anti-business, since it had aroused animosity in the business community by its attempts to control price increases by some of the country's largest industrial firms.

Generally speaking, however, one would expect any relatively doubtful case to lead either to no ruling at all or to a ruling unfavorable to the taxpayer. It is expected that the government, through the Internal Revenue Service, will generally take a position that favors increasing the revenue, and that seems fair.

Business must go on, however, and in many cases it cannot proceed without a ruling clarifying a doubtful area. Overall fairness and the exigencies of the situation may suggest that the Service take a more neutral, quasi-judicial position in such cases and issue a ruling that takes into consideration the fact that the Service is the court of last resort and that its disposition may not be reviewable. But generally the Service takes a pro-revenue position in regulations, in rulings, and in its litigating and examination positions.

The favorable ruling issued in this case does not fit this ordinary picture. The Service turned its back on a defensible, revenue producing, judicially reviewable position in favor of

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79. *See* 15 U.S.C. § 15(a) (1964); 31 U.S.C. § 231 (1964); United States v. Cooper Corp., 312 U.S. 600 (1941).

one that is difficult to defend, costs the government revenue, and cannot be judicially reviewed.

While it has been argued that an unfavorable ruling would have had serious detrimental effects upon competition in industry, this is hardly the sort of factor the Internal Revenue Service is equipped to weigh, and its relevance in a tax determination is doubtful. Although it was argued that the settlement of lawsuits would be encouraged by the ruling, it is not clear why that is so. If the benefits of a plaintiff's winning are the same, either way, but the penalties of a defendant losing are increased, it would seem that the defendants would have even more incentive to settle.

It is granted that the Internal Revenue Service does perform a socially useful function by issuing private and public rulings, and that there are some advantages in having the Service, in certain cases, grant favorable rulings in doubtful areas. However, to have done so in this case was a grave abuse of discretion.

V. CONCLUSION

The issuance by the Internal Revenue Service of Revenue Ruling 64-224 permitting the deduction of antitrust treble damage payments to a private person as a business expense but denying the deduction for simple damage payments to the government was unwarranted. The relevant authorities are at best ambiguous and do not compel the result reached. The Service abandoned its traditional position of not issuing a revenue ruling favoring the taxpayer in doubtful cases. Finally and most importantly, a balancing of the public policies underlying both the income tax and the antitrust laws indicates that the deduction of at least the punitive two-thirds of a private treble damage payment should be denied and that the other one-third of a private payment and damage payments to the government should be given consistent treatment.